

Letter of Findings Number: 02-20110459
Adjusted Gross Income Tax
For Tax Years 2007-08

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ISSUE

I. Adjusted Gross Income Tax–Intangible Expense Add-Back.

Authority: 26 U.S.C. § 1504; IC § 6-3-2-1; IC § 6-3-2-2; IC § 6-3-2-20; IC § 6-8.1-5-1.

Taxpayer protests the Department's adjustments to Taxpayer's reported intangible expense add-back.

STATEMENT OF FACTS

Taxpayer is a business with operations in Indiana and other states. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had incorrectly reported its Indiana adjusted gross income ("AGIT") for the tax years 2007 and 2008. The Department therefore issued proposed assessments for AGIT, penalty, and interest for both years. Taxpayer protests that it correctly reported AGIT for those years and that the Department's proposed assessments are incorrect. A hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Adjusted Gross Income Tax–Intangible Expense Add-Back.

DISCUSSION

Taxpayer protests the Department's adjustments to Taxpayer's 2007 and 2008 Indiana AGIT. Specifically, Taxpayer protests that the Department erred when it disallowed a reduction of Taxpayer's intangible expense add-back ("add-back") as reported on Taxpayer's Indiana AGIT returns for those years. The Department based its decision to disallow the reduction on its determination that Taxpayer did not meet the statutory exceptions required to allow such a reduction. Taxpayer protests that not only does it meet the statutory exceptions, but that the statute itself is not applicable to it. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as required by IC § 6-8.1-5-1(c).

The adjusted gross income tax is imposed under IC § 6-3-2-1, which states:

- (a) Each taxable year, a tax at the rate of three and four-tenths percent (3.4 [percent]) of adjusted gross income is imposed upon the adjusted gross income of every resident person, and on that part of the adjusted gross income derived from sources within Indiana of every nonresident person.
- (b) Except as provided in section 1.5 of this chapter, each taxable year, a tax at the rate of eight and five-tenths percent (8.5 [percent]) of adjusted gross income is imposed on that part of the adjusted gross income derived from sources within Indiana of every corporation.

Also of relevance is IC § 6-3-2-2(a), which states:

With regard to corporations and nonresident persons, "adjusted gross income derived from sources within Indiana", for the purposes of this article, shall mean and include:

- (1) income from real or tangible personal property located in this state;
- (2) income from doing business in this state;
- (3) income from a trade or profession conducted in this state;
- (4) compensation for labor or services rendered within this state; and
- (5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter.

Also, IC § 6-3-2-20 provides in relevant parts:

(a) The following definitions apply throughout this section:

- (1) "Affiliated group" has the meaning provided in Section 1504 of the Internal Revenue Code, except that the ownership percentage in Section 1504(a)(2) of the Internal Revenue Code shall be determined using fifty percent (50[percent]) instead of eighty percent (80[percent]).

...

(b) Except as provided in subsection (c), in determining its adjusted gross income under [IC 6-3-1-3.5\(b\)](#), a corporation subject to the tax imposed by [IC 6-3-2-1](#) shall add to its taxable income under Section 63 of the Internal Revenue Code:

- (1) intangible expenses; and
- (2) any directly related intangible interest expenses;

paid, accrued, or incurred with one (1) or more members of the same affiliated group or with one (1) or more foreign corporations.

....

(Emphasis added).

I.R.C. § 1504 (26 U.S.C. § 1504) provides in relevant parts:

(a) Affiliated group defined

For purposes of this subtitle—

(1) In general

The term "affiliated group" means—

(A) 1 or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation, but only if—

...

(b) Definition of "includible corporation"

As used in this chapter, the term "includible corporation" means any corporation except—

(1) Corporations exempt from taxation under section 501.

(2) Insurance companies subject to taxation under section 801.

(3) Foreign corporations.

(4) Corporations with respect to which an election under section 936 (relating to possession tax credit) is in effect for the taxable year.

[(5) Repealed. Pub. L. 94-455, title X, § 1053(d)(2), Oct. 4, 1976, 90 Stat. 1649.]

(6) Regulated investment companies and real estate investment trusts subject to tax under subchapter M of chapter 1.

(7) A DISC (as defined in section 992 (a)(1)).

(8) An S corporation.

....

As the result of its audit, the Department determined that add-back reduction was incorrect. In its audit report, the Department listed several factors which led to this conclusion.

Taxpayer states that it did include the add-back as required by IC § 6-3-2-20(b) and that it followed the directions of what was required to be included in the add-back calculations by following the definition of "affiliated group" in I.R.C. § 1504(a)(1)(A), as required by IC § 6-3-2-20(a)(1). The amount of the add-back reduced by Taxpayer was the amount of intangible expenses paid, accrued, or incurred by a related LLC, not a corporation. Taxpayer believes that, since an "affiliated group" is defined by I.R.C. § 1504(A)(1) as includable corporations, and since the related LLC is not a corporation, that the LLC is not included in the affiliated group and any intangible expenses are not included in the Indiana AGIT intangible expense add-back calculations.

After a review of the supporting documentation supplied by Taxpayer and of the relevant statutes, the Department agrees with Taxpayer. The LLC is treated at the Federal level as a partnership, not as a corporation, and is neither an "includable corporation" nor a member of the "affiliated group" as defined by I.R.C. § 1504. Since it is not a member of the affiliated group, the intangible expenses paid, accrued, or incurred by the LLC are not included in the add-back calculations under IC § 6-3-2-20. Since the Department based its determination solely on the provisions of IC § 6-3-2-20, and since Taxpayer has established that it followed the statutory requirements of IC § 6-3-2-20 for 2007 and 2008, under these particular facts and for this particular taxpayer, Taxpayer has met the burden imposed by IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is sustained.

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